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No. 04-1704

Supreme Court, U.S.
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In the

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION, et al.,

Petitioners,

v.

CHARLOTTE CUNO, et al.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Do respondents have standing to challenge Ohio's investment tax credit, Ohio Rev. Code Ann. § 5733.33?

2. The "Dormant Commerce Clause" forbids states from using their internal regulatory powers as barriers to exclude out-of-state businesses from competing against in-state businesses. Ohio's investment tax credit gives tax breaks and other incentives to out-of-state businesses to encourage them to enter and expand their business operations within Ohio. Does the tax credit violate the Dormant Commerce Clause?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

IDENTITY AND INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 3

I. BEFORE CONSIDERING DISMISSAL, THIS COURT MUST FIRST DETERMINE WHETHER THE DISTRICT COURT HAD ORIGINAL JURISDICTION OVER THE CASE ... 3

A. State Courts Have Power to Decide Federal Constitutional Issues, and Are the Best Courts Suited to Deciding State Constitutional Questions 5

B. Ohio Courts Had Jurisdiction to Hear This Case 7

C. If This Court Determines That Plaintiffs Lack Standing on This Case, the Court Should Examine Whether the District Court Had Jurisdiction over Other Causes of Action to Decide Whether to Remand or to Dismiss ... 8

II. OHIO'S INVESTMENT TAX CREDIT DOES NOT VIOLATE THE COMMERCE CLAUSE 9

A. The Commerce Clause Forbids Trade Barriers Between States, but the Ohio Tax Incentive Is Not a Trade Barrier 9

TABLE OF CONTENTS—Continued

Page

B. The "Diversionary Effects" of State Tax Policy Are Not Sufficient to Violate the Commerce Clause 12

C. Without Protectionist Intent or Burdens on Interstate Competition, a Tax Incentive Does Not Violate the Commerce Clause 14

III. THE DECISION BELOW THREATENS IMPORTANT FEDERALISM PRINCIPLES 17

A. The "Diversion" Theory Would Require All State Tax and Regulatory Policies to Be Uniform 17

B. The Decision Below Would Interfere with "Competitive Federalism" 19

CONCLUSION 23

TABLE OF AUTHORITIES

Page

Cases

Am. Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987) 17

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Armco Inc. v. Hardesty, 467 U.S. 638 (1984) 2

ASARCO Inc. v. Kadish, 490 U.S. 605 (1989) 5-6

Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 12, 15-16, 23

Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) 15

Bank of America v. San Francisco, 309 F.3d 551 (9th Cir. 2002) 1

Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) 11, 15, 23

Caterpillar Inc. v. Lewis, 519 U.S. 61 (1996) 8

Chrysler Rail Transp. Corp. v. Holt, 845 F. Supp. 463 (D. Mich. 1994) 12

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TABLE OF AUTHORITIES—Continued

Page

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Gonzales v. Raich, 125 S. Ct. 2195 (2005) 1

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TABLE OF AUTHORITIES—Continued

Page

State ex rel. Nimon v. Vill. of Springdale, 215 N.E.2d 592 (Ohio 1966) 7

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U.S. Const. amend. XIV 18

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28 U.S.C. § 1441(a) 6

§ 1441(c) 6

§ 1447 8

State Statute

Ohio Rev. Code Ann. § 733.59 7

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U.S. Sup. Ct. R. 37.3 1

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Page

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Page

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IDENTITY AND INTEREST OF AMICUS CURIAE[1]

Pursuant to Supreme Court Rule 37.3, Pacific Legal Foundation (PLF) respectfully submits this brief amicus curiae in support of the petitioners. Written consent was granted by counsel for all parties and lodged with the Clerk of this Court.

Pacific Legal Foundation was founded over 30 years ago and is widely recognized as the largest and most experienced nonprofit legal foundation of its kind. PLF litigates matters affecting the public interest at all levels of state and federal courts and represents the views of thousands of supporters nationwide who believe in limited government and economic freedom. As part of its litigation practice, PLF routinely litigates in defense of state and federal constitutional rights in federal district and appellate courts. PLF is therefore especially interested in the standing question presented in this case. PLF has participated in many cases in support of state autonomy within the Constitution's system of federalism, including *Gonzales v. Raich*, 125 S. Ct. 2195 (2005) and *Franchise Tax Bd. of California v. Hyatt*, 537 U.S. 946 (2002). In addition, PLF's Free Enterprise Project defends the freedom of economic opportunity both through direct litigation and by participating as amicus curiae in state and federal courts. PLF has participated as amicus in cases such as *RUI One Corp. v. City of Berkeley*, 371 F.3d 1137 (9th Cir. 2004), *cert. denied*, 125 S. Ct. 895 (2005); and *Bank of America v. San Francisco*, 309 F.3d 551 (9th Cir. 2002). Because of its history and expertise with regard to civil rights litigation, economic freedom, and federalism, PLF believes its perspective will aid this Court in considering this case.

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[1] Counsel for a party did not author this brief in whole or in part. No person or entity, other than amicus curiae, made a monetary contribution specifically for the preparation or submission of this brief.

SUMMARY OF ARGUMENT

In addition to the issue brought to the Court by the parties, this Court requested briefing on the standing of plaintiffs to challenge state income tax credits. That question, however, is too narrow. Whether plaintiffs have standing to present this claim in federal court, the plaintiffs most assuredly had standing to bring this case in the Ohio state courts where the case was initially filed. This case is in the federal courts only because the defendants removed the action. That removal, however, is valid only if the district court had original jurisdiction over the action. A finding that plaintiffs do not have standing to pursue the particular argument now before the Court does not answer this question. Instead, the Court must examine the entire case to determine whether the federal courts had subject matter jurisdiction. If jurisdiction was lacking, the entire case must be remanded to the state courts.

On the merits of the claim, it is true that "the Commerce Clause of its own force protects free trade among the States." *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). This is what the framers of the Clause intended, and Chief Justice Marshall was correct to hold in *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 209 (1824), that Congress' authority to regulate interstate commerce "excludes, necessarily, the action of [States] that would perform the same operation on the same thing." In particular, the Clause forbids domestic economic interest groups from using the state's regulatory power to exclude competition from outsiders. However, the Commerce Clause also leaves the states with autonomy to regulate internal affairs, including authority to design their taxes and regulations in ways they believe will encourage interstate competition. In this case, the Ohio tax incentive encourages out-of-state businesses to enter and do business in Ohio. It is not exclusionary legislation, but an invitation that imposes no burden on interstate commerce.

The Court below held that a tax incentive program violates the Commerce Clause if it results in "diversion of interstate commerce from the most economically efficient channels." *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738, 744 (6th Cir. 2004). But this Court has never held that "diversion" alone violates the Commerce Clause. It has always required some degree of burden on interstate commerce that creates a barrier to entry into the state. Since no burden is present here, the decision below should be reversed.

Nor should this Court adopt the "diversion" theory of the Dormant Commerce Clause. That theory would severely limit the autonomy of the states, which is protected under the Commerce Clause. State autonomy results in "competitive federalism" in which states compete with one another to provide the best regulatory regime for mobile citizens. Consequently, states have created widely different business environments: states like Oregon and Montana have no sales tax, for instance, and Nevada allows legal gambling. These variations cause significant "diversion" of interstate commerce. If the decision below is affirmed, states will be forbidden to institute such diverse tax and regulatory environments. This should not happen. Tax incentives improve interstate competition, benefit the citizenry, and pose no realistic danger to interstate comity. The decision below should be reversed.

ARGUMENT

I

BEFORE CONSIDERING DISMISSAL, THIS COURT MUST FIRST DETERMINE WHETHER THE DISTRICT COURT HAD ORIGINAL JURISDICTION OVER THE CASE

The plaintiffs filed their case, claiming that the statutes at issue violated the Ohio State Constitution as well as the United States Constitution, in Ohio state court. Based on the presence

of a federal issue, DaimlerChrysler (with the state's consent) removed the action to federal court. In conjunction with the plaintiffs' motion for remand, DaimlerChrysler and the state argued that plaintiffs had standing to bring the case in the federal courts.[2]

Amicus will leave the arguments on plaintiffs' standing to the parties (and we expect the parties to argue that Kim's Auto does have standing because of the unique injury that it alleged).[3] Amicus does argue, however, that before a removed action can be dismissed for lack of standing, this Court must review the entire complaint to determine whether the action was within the original jurisdiction of the district court. If not, the case must be remanded back to the Ohio state courts.

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[2] Memorandum Opinion (Denying Motion to Remand) at 5-6 ("Plaintiffs have not been able to bring themselves to argue that they completely lack standing in federal court; on the other hand, the Defendants have not been overly eager to argue that Plaintiffs have adequate standing to appear in this Court . . . Of course, since the Defendants removed this action to federal court, the burden of proving jurisdiction, and therefore standing, is theirs"). The District Court ultimately ruled that Plaintiffs had "municipal taxpayer" standing under *Massachusetts v. Mellon*, 262 U.S. 447, 486 (1923), to challenge the property tax exemption. Memorandum Opinion at 6-7.

[3] Complaint for Declaratory and Injunctive Relief ¶¶ 41-42 (alleging that plaintiff Kim's Auto and Truck Services, Inc., suffered business injuries from the expansion of the jeep plant that would not have happened but for the state income tax credit.)

A. State Courts Have Power to Decide Federal Constitutional Issues, and Are the Best Courts Suited to Deciding State Constitutional Questions

"It, of course, is clearly established that state supreme courts get the final word as to the interpretation of state law." Erwin Chemerinsky, *Closing the Courthouse Doors to Civil Rights Litigants*, 5 U. Pa. J. Const. L. 537, 555 (2003). It is equally clear that state courts also "possess the authority, absent a provision for exclusive federal jurisdiction, to render binding judicial decisions that rest on their own interpretations of federal law." *ASARCO Inc. v. Kadish*, 490 U.S. 605, 617 (1989). When state courts address issues of federal law, they are not bound by the same Article III considerations that define the jurisdiction of the federal courts. *Id.*; *Int'l Primate Prot. League v. Administrators of Tulane Educ. Fund*, 500 U.S. 72, 78 n.4 (1991). A party without standing in federal court (and thus unable to invoke the court's jurisdiction) may well have standing to make the same arguments in state court. *See ASARCO*, 490 U.S. at 617 ("[w]e have recognized often that the constraints of Article III do not apply to state courts, and accordingly the state courts are not bound by the limitations of a case or controversy or other federal rules of justiciability even when they address issues of federal law"); *Int'l Primate Prot. League*, 500 U.S. at 78 n.4 (Article III requirements do not apply in state courts).

This difference in the jurisdiction of state and federal courts stems from the fact that state courts exercise a reserved judicial power, *Healy v. Ratta*, 292 U.S. 263, 270 (1934), and is firmly entrenched in our system of federalism, Briant S. Platt, *Section 1446(b) Federal Removal Jurisdiction and the Thirty-Day Clock: Should a Motion to Amend Trigger the Time Bomb?*, 4 Nev. L.J. 120, 130 (2003). Federalism does not just describe a system of disbursed power. Instead it "is commonly understood as a mechanism designed to institutionalize a

permanent struggle between state and national power" as a means of protecting individual liberty. James A. Gardner, *State Courts as Agents of Federalism: Power and Interpretation in State Constitutional Law*, 44 Wm. & Mary L. Rev. 1725, 1728 (2003). As such, "[f]ederalism thus is not a historical oddity best left to disappear, but rather the people's safety net." Marci A. Hamilton, *Federalism and the Public Good: The True Story Behind the Religious Land Use and Institutionalized Persons Act*, 78 Ind. L.J. 311, 323 (2003).

These considerations were at the forefront when this Court counseled caution in exercising removal jurisdiction: "Due regard for the rightful independence of state governments, which should actuate federal courts, requires that they scrupulously confine their own jurisdiction to the precise limits which the statute has defined." *Ratta*, 292 U.S. at 270. In the time since the decision in *Ratta*, the scope of removal jurisdiction has grown. Yet it is still true that removal jurisdiction does not lie unless the district court has original jurisdiction over at least one of the causes of action. 28 U.S.C. § 1441(a). This is important because when a case is removed to federal court, the entire case is removed. 28 U.S.C. § 1441(c). This results in the federal courts sitting as courts of last resort on issues of state statutory and constitutional law. Thus when this case involving both state and federal causes of action was removed to federal court, it was the federal court that ruled on the application of Ohio's state constitution to the claims at issue here. Had the case remained in the state court system, however, defendants would have retained access to the federal courts on the federal claims. *See ASARCO*, 490 U.S. at 619. Before dismissing any removed case, therefore, this Court should first assure itself that the case was within the original jurisdiction of the district court.

B. Ohio Courts Had Jurisdiction to Hear This Case

This Court has raised the question of whether the federal courts have subject matter jurisdiction over the one remaining claim in the case. There is no question, however, that the Ohio courts had jurisdiction over the case as originally filed. Like most states,[4] Ohio recognizes the standing of taxpayers to enforce public duties. Indeed, taxpayer standing is provided for by an Ohio statute. Ohio Rev. Code Ann. § 733.59. Ohio, however, goes further than many states in that it does not require any showing of injury to the public fisc in order to maintain an action as a taxpayer:

> [W]here the question is one of public right and the object of the mandamus is to procure the enforcement of public duty, the people are regarded as the real party and the relator need not show that he has any . . . special interest in the result, since it is sufficient that he is interested as a citizen or taxpayer in having the laws executed and the duty in question enforced.

State ex rel. Nimon v. Vill. of Springdale, 215 N.E.2d 592, 595 (Ohio 1966) (citation omitted). Thus, had this case not been removed to federal court, the Ohio courts had jurisdiction to consider the state and federal constitutional claims raised in plaintiffs' complaint.

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[4] The leading survey on this issue is *Taxpayers' Suits: A Survey and Summary*, 69 Yale L.J. 895 (1960). At the time of that article, 34 states recognized taxpayer standing to challenge state agency actions, and all of the states recognized taxpayer standing to challenge municipal actions. *Id.* at 895-96.

C. If This Court Determines That Plaintiffs Lack Standing on This Case, the Court Should Examine Whether the District Court Had Jurisdiction over Other Causes of Action to Decide Whether to Remand or to Dismiss

The jurisdictional inquiry does not come to an end if this Court finds that the plaintiffs do not have standing on the state income tax claim. Instead, the Court must search the complaint in the case and determine if the federal courts ever had jurisdiction over *any part* of the case. *See* 28 U.S.C. § 1447. As noted by then Judge Breyer in writing for the First Circuit: "We think, however, that the district court erred in departing from the literal words of § 1447(c), which, on their face, give it no discretion to dismiss rather than remand an action. And, we are unwilling to read such discretion into the statute." *Maine Ass'n of Interdependent Neighborhoods v. Comm'r, Maine Dep't of Human Services*, 876 F.2d 1051, 1054 (1st Cir. 1989). Although the statute imposes on the district court a duty to remand before judgment, that duty has been applied any time the federal courts discover they are without subject matter jurisdiction. *See, e.g., Coyne v. Am. Tobacco Co.*, 183 F.3d 488, 496 (6th Cir. 1999).

This Court has also ruled that there is no room for discretion in the command of section 1447. *Int'l Primate Prot. League*, 500 U.S. at 89 (citing *Maine Ass'n of Interdependent Neighborhoods*, 876 F.2d at 1054-55). Thus, if the district court did not have subject matter jurisdiction, the jurisdictional defect is fatal as far as federal courts are concerned. *Cf. Caterpillar Inc. v. Lewis*, 519 U.S. 61, 64 (1996). Because this Court has requested briefing on plaintiffs' standing on only a small part of the original action, the Court will not be in a position to determine whether the federal district court had subject matter jurisdiction.

If the district court did not have jurisdiction, then a dismissal at this juncture will mean that a federal court without jurisdiction over the matter was the court of last resort on the meaning and application of the Ohio State Constitution. This Court should not countenance such a significant intrusion into the jurisdiction of Ohio's state courts. Instead, if this Court finds that plaintiffs lack standing to challenge the state income tax incentives in federal court, the Court must also review whether plaintiffs had *federal* court standing to challenge the property tax exemption. If not, then the district court never had jurisdiction and the entire case should be remanded to the Ohio state court.

II

OHIO'S INVESTMENT TAX CREDIT DOES NOT VIOLATE THE COMMERCE CLAUSE

A. The Commerce Clause Forbids Trade Barriers Between States, but the Ohio Tax Incentive Is Not a Trade Barrier

The Court of Appeals' primary error lies in its failure to focus on the underlying purpose of the Dormant Commerce Clause. The "Dormant Commerce Clause" is unfortunately named, because it is not really "dormant" at all; it is simply a logical consequence of the unambiguous supremacy of federal authority to regulate commerce among the several states. *See Gibbons*, 22 U.S. (9 Wheat.) at 206, 209-10.

The Commerce Clause was written to encourage free commerce between the several states by giving the federal government the supreme authority to "produce[] a uniform whole," *id.* at 209, by "control[ling] the State laws, so far as it may be necessary to control them, for the regulation of commerce." *Id.* at 206. Before the Constitution of 1787, states were engaged in various protectionist schemes to give their domestic producers unfair legal advantages against out-of-state

producers. Each state "pursued its own real or supposed local interests; each was jealous of the rivalry of its neighbors; and each was successively driven to retaliatory measures." Joseph Story, *A Familiar Exposition of the Constitution of the United States* 140 (Regnery Gateway, Inc., 1986) (1859). The "distinctions, preferences, and exclusions" that states engaged in—such as taxing each others' exports, levying different taxes on goods that traveled from states without ports into states with ports, and so forth—led to "unceasing animosit[y]." *The Federalist* No. 7, at 116 (Alexander Hamilton); No. 42, at 305 (James Madison) (Benjamin Fletcher Wright ed., Barnes & Noble, Inc. 1996). The Constitution therefore gave Congress "a superintending authority over the reciprocal trade of confederated States," so as to stop wasteful and politically dangerous trade wars. *Id.* at 306. As Justice Jackson explained in his particularly eloquent opinion, *H. P. Hood & Sons, Inc. v. Du Mond,* 336 U.S. 525, 538-39 (1949),

> The material success that has come to inhabitants of the states which make up this federal free trade unit has been the most impressive in the history of commerce . . . . We need only consider the consequences if each of the few states that produce copper, lead, high-grade iron ore, timber, cotton, oil or gas should decree that industries located in that state shall have priority. What fantastic rivalries and dislocations and reprisals would ensue if such practices were begun!

The Commerce Clause, Jackson continued, ensures "that every farmer and every craftsman . . . will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them." *Id.* at 539. Thus the Clause allows the merchants in one state to do business in another by ensuring that states do not give in to the pressures of domestic lobbyists to keep out competition.

The tax credit here *does not exclude* out-of-state merchants. It is not a "reprisal" or a "dislocation" or a "home embargo." *Id.* at 539. On the contrary, it *serves* the goals of the Dormant Commerce Clause by further knitting the interstate market together. It is not a barrier to keep out competition; it *encourages* competition by inviting out-of-state businesses to enter and participate in the local economy. This is the opposite of the "Balkanization" that was the ultimate evil the Commerce Clause's authors sought to avoid. And it has beneficial effects on the consumer, in that it drives down prices, and increases the availability of goods and services on the market. When a law is not "motivated by preference for local interests as such over foreign interests," it should not be held to violate the Commerce Clause. Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1253 (1986).

In addition, "there must be a negative impact on interstate commerce before an unconstitutional burden on interstate commerce will be found." Philip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 Vand. L. Rev. 879, 930 (1986). This Court's words in *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 (1997), are equally appropriate here: "eliminating the tax or other regulatory differential would not serve the dormant Commerce Clause's fundamental objective of preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors."

This Court has never held that states are barred from "structuring their tax systems to encourage the growth and development of intrastate commerce and industry" or "compet[ing] with other States for a share of interstate commerce." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336-37 (1977). In fact, the Court repeatedly has stated that "States may try to attract business by creating an environment

conducive to economic activity." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 n.15 (1994). *See also Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984) ("a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry").

B. The "Diversionary Effects" of State Tax Policy Are Not Sufficient to Violate the Commerce Clause

Tax incentives that a state gives to out-of-state businesses to encourage them to do business within the state may well have "diversionary" effects on the national economy—meaning that they will lead a business to locate in one state over another. But the theory that these effects alone violate the Commerce Clause appears to have originated in a deeply flawed law review article published ten years ago. *See* Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv. L. Rev. 377 (1996). Enrich began with the erroneous assertion that tax incentives are bad for society—an assertion he supported by claiming that such incentives "incur a very substantial loss of tax revenues," *id.* at 398. But the Constitution does not forbid a state from choosing to forego potential tax revenues. Tax revenues do not exist in a state of nature—they are imposed by a legislature which decides to tax. If the legislature chooses not to tax, or chooses to tax less than it might otherwise do, it has hardly violated any duty it owes to citizens or American society. *Cf. Chrysler Rail Transp. Corp. v. Holt*, 845 F. Supp. 463, 468 (D. Mich. 1994) ("[t]he State has chosen not to spend the time and money to actively seek out ownership information . . . but instead has applied the tax if and when relevant ownership information becomes available . . . . While this method of enforcing the tax codes may be inefficient, it is not illegal").

Enrich's understanding of the economics of tax incentives contains additional flaws. First, his contention that tax

incentives cause states to compete "for a finite pool of businesses and jobs" reflects a profound misunderstanding of the nature of the free market. Enrich, *supra*, at 401. The economy is not a zero-sum game featuring a "finite pool" of businesses and jobs: on the contrary, a free market creates *new* jobs and new businesses through the process of competition and expansion. *See* George Reisman, *Capitalism: A Treatise on Economics* 343 (1996) ("competition . . . in a division-of-labor, capitalist society . . . . [is] not . . . [for] the seizure of a fixed supply of [goods] provided by nature . . . . [but] in the positive creation of [new products]").

Even more astonishingly, Enrich complains that tax incentives are implemented by "decisionmakers [who] are accountable to voters"! Enrich, *supra*, at 402. He contends that economic policies should be set instead by "rational" decision makers who are *not* subject to "a wide range of political considerations." *Id.* at 402. But the Constitution *fosters* a system whereby a state's economic decisions are made on the basis of a wide range of political considerations by people who are accountable to voters. *See, e.g., Turner Broad. Sys., Inc. v. FCC*, 520 U.S. 180, 195 (1997) (legislatures are " 'far better equipped than the judiciary to "amass and evaluate the vast amounts of data" bearing upon' legislative questions" (citations omitted)). And the Commerce Clause *encourages* a national system of exchange and competition, including competition by states seeking to offer the most attractive business environment to companies that can choose where to do business. *See, e.g., New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988) ("[t]he Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce.* Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does").

Further, although Enrich claims that interstate competition for the attention of businesses "engender[s] intense and often hostile rivalries between the states," he provides no serious support for this claim. Enrich, *supra*, at 400. His only examples of such "hostility" are the "martial metaphors" used by state politicians when discussing competition: politicians and lawyers used terms like "first-strike attack" and "second war between the states" when discussing the fact that legislatures try to make their states more attractive to business. *Id.* at 400-01 (citation omitted). But rhetorical flourishes hardly rise to the level of outright conflict that occurred in the United States under the Articles of Confederation and gave rise to the Commerce Clause. *See* Grant S. Nelson & Robert J. Pushaw, Jr., *Rethinking the Commerce Clause: Applying First Principles to Uphold Federal Commercial Regulations but Preserve State Control over Social Issues*, 85 Iowa L. Rev. 1, 23-24 (1999) (describing how states enacted "debtor relief laws, which enabled borrowers to avoid their contractual obligations and authorized the emission of worthless paper money" as well as "protectionist trade laws, taxes, and port fees" that led to "[b]order quarrels . . . and regional economic tensions"). In fact, there is no reason to believe that tax incentives are a threat to peace between the states, or that they harm citizens.

C. Without Protectionist Intent or Burdens on Interstate Competition, a Tax Incentive Does Not Violate the Commerce Clause

The theory that "diversion" of the market itself violates the Dormant Commerce Clause finds no support in either the Clause's history or the cases interpreting it. The Commerce Clause only prohibits states from "plac[ing] *burdens* on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995) (emphasis added). Thus "a tax impermissibly discriminates in violation of the Clause if it expresses the taxing authority's 'preference for

domestic commerce over foreign commerce,' by *disadvantaging foreign corporations or goods*, or by *restricting* the free flow of goods between states." *Polychrome Int'l Corp. v. Krigger*, 5 F.3d 1522, 1539 (3d Cir. 1993) (emphasis added; citations omitted). As a result, this Court has always insisted on some evidence of a protectionist goal in a law—some legislative design to prevent competition within a state by out-of-state interests—before finding that it violates the Commerce Clause. In *Bacchus Imports*, 468 U.S. at 271, for example, the Court found a Hawaii law which taxed imported wine but not locally produced wine to be an unconstitutional protectionist measure because it "'discriminat[ed] in favor of goods, wares, and merchandise which are the growth, product, or manufacture of the State, and against those which are the growth, product, or manufacture of other states or countries'" (quoting *Welton v. Missouri*, 91 U.S. 275, 277 (1875)). In *Boston Stock Exch., supra*, the Court held that New York could not tax out-of-state stock transactions more heavily than in-state transactions, because doing so was the sort of "favor [to] local enterprises at the expense of out-of-state businesses" which the Commerce Clause abhors. 429 U.S. at 329.

In addition to the presence of a protectionist intent, the Court has always required the showing of some sort of burden on out-of-state producers. *See Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644, 669-70 (2003). In the absence of an actual burden on out-of-state producers, even a law which gives benefits to in-state producers has not been held to violate the Clause. *Id.* In *Walsh*, the Court held that a Maine law permitting reimbursement of local pharmacies for drugs dispensed to the indigent did not violate the Commerce Clause. It distinguished three cases—*Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), *Healy v. Beer Inst.*, 491 U.S. 324 (1989), and *West Lynn Creamery*, 512 U.S. at 186—on the grounds that each of those cases involved actual burdens on out-of-state businesses. In *Baldwin* and *Beer Inst.*, the challenged laws

prohibited out-of-state producers from selling in the state unless they conformed to officially set minimum prices; in *West Lynn Creamery*, the out-of-state producers were taxed to support a subsidy paid to the in-state producers.

Unlike those cases, however, out-of-state businesses experience no burden under Ohio's tax incentive program. They are simply obtaining or foregoing a benefit which is entirely within Ohio's discretion to grant or to deny. "[A] state tax incentive that focuses exclusively on a taxpayer's in-state activities does not have the sort of negative impact on interstate commerce with which the commerce clause is concerned." Tatarowicz & Mims-Velarde, *supra*, at 928-29.

A finding that market "diversion" *alone* violates the Commerce Clause—without any showing of a legislative plan to bar competition or to burden out-of-state businesses—has never been endorsed by the Court. Even in *Bacchus Imports,* the Court explicitly refused to ignore the legislative intent to favor domestic industry over foreign industry. 468 U.S. at 274. *See also Dominion Nat'l Bank v. Olsen*, 771 F.2d 108, 117 (6th Cir. 1985) ("a tax is found to be discriminatory . . . *where the underlying purpose of the tax is simple economic protectionism* as opposed to some other arguably legitimate state purpose") (emphasis added). Here, however, there is no intent to benefit local industry at the expense of out-of-state industry. On the contrary, the tax benefit is offered principally to out-of-state businesses, to encourage them to participate in the local economy.

Also, the *Bacchus Imports* decision did not find—contrary to the opinion below—that the difference between a benefit to in-state businesses and a burden to out-of-state businesses was irrelevant. Rather, *Bacchus Imports* holds that *once a law is found to treat businesses unequally on the basis of their location*, the distinction between benefits and burdens does not apply. 468 U.S. at 273. The Hawaii tax exemption was not

available to out-of-state wine producers doing business in Hawaii, meaning that the benefit to in-state producers was *exclusive*, and therefore an inherent burden on interstate commerce. But here, the benefit is available to out-of-state businesses. The tax credit here does not create a trade barrier, does not exclude competition, does not erect "a financial barrier around the State," *Am. Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266, 284 (1987), and does not create any serious controversies between states. The Commerce Clause was intended to create a free-trade zone within the United States, and that purpose is advanced only by allowing states to cut taxes in an effort to increase the state's economic competitiveness. In the absence of some burden on out-of-state businesses, a tax incentive plan simply cannot be held to violate the Commerce Clause. *See* Tatarowicz & Mims-Velarde, *supra*, at 928-29. The Clause provides no warrant for prohibiting Ohio from basing its tax policy on its view of what will encourage businesses to locate there.

III

THE DECISION BELOW THREATENS IMPORTANT FEDERALISM PRINCIPLES

A. The "Diversion" Theory Would Require All State Tax and Regulatory Policies to Be Uniform

The framers of the Constitution did not intend for the Clause to interfere with the "independent and uncontrollable authority to raise revenue to any extent of which they may stand in need, by every kind of taxation, except in duties on imports and exports." *The Federalist* No. 33, *supra* at 248 (Alexander Hamilton). To hold, as the decision below does, that a law usurps federal authority over interstate commerce whenever it "[diverts] interstate commerce from the most economically efficient channels," *Cuno*, 386 F.3d at 744—even though such a law actually *encourages* out-of-state producers to do business

there—would seriously harm the independent regulatory authority of states.

Under the Court of Appeals' "diversion" test, anything short of a completely uniform national flat tax and a complete abolition of state regulatory discretion, would be unconstitutional, because anything other than a uniform policy will divert interstate commerce from its most economically efficient channels. The Constitution allows states wide discretion to choose how to regulate and tax businesses, and that includes (within the boundaries of the Fourteenth Amendment) the discretion to base those choices on what they believe will protect the public health and safety, and what they believe will encourage the development of local economies.

One of the primary virtues of federalism is that it allows regulatory decisions to be made at the level closest to those who are regulated. It makes sense that decisions with regard to the taxation and regulation of the business of a state should be made by those who are most affected by such decisions, rather than by people in a far-distant national capital. *See, e.g., Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991) ("decentralized government that will be more sensitive to the diverse needs of a heterogenous society"). Thus, as Madison explained, the Constitution delegates to the federal government power over "external objects, as war, peace, negotiation," while leaving to the states the authority over those things "which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, *improvement, and prosperity* of the State." *The Federalist* No. 45, *supra* at 328 (James Madison) (emphasis added). Requiring people in vastly different states to adhere to a uniform tax and regulatory policy so as to avoid "diverting interstate commerce from the most economically efficient channels" would handicap the independent authority of states in this regard. The Constitution does not "abrogat[e] or prevent[] the collection of a tax laid by the authority of the State (unless upon imports and

exports)...." *The Federalist* No. 33, *supra* at 247 (Alexander Hamilton).

The "diversion" theory on which the court below relied would impose a uniformity on state economic policies, however—a uniformity which would conflict with this principle of home rule. Indeed, Enrich, *supra*, argued that courts should adopt this theory as a means of "saving the states from themselves," *id.* at 377—hardly the role of a Court which recognizes "that, under our federal system, the States possess sovereignty concurrent with that of the Federal Government, subject only to limitations imposed by the Supremacy Clause," *Tafflin v. Levitt*, 493 U.S. 455, 458 (1990).

Enrich acknowledged that his theory would impose "unprecedented" limits on the "state independence" which this Court has repeatedly described as one of the most basic elements of our constitutional structure. *See* Enrich, *supra* at 466. His answer to this problem, however, was to propose that states find other ways of encouraging economic growth. This is not convincing. "Were the Federal Government to take over the regulation of entire areas of traditional state concern . . . the boundaries between the spheres of federal and state authority would blur and political responsibility would become illusory." *United States v. Lopez*, 514 U.S. 549, 572 (1995) (Kennedy and O'Connor, JJ; concurring).

B. The Decision Below Would Interfere with "Competitive Federalism"

Complimenting this concept of state autonomy is the concept of "competitive federalism." *See, e.g.*, Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. Chi. L. Rev. 1484, 1498-1500 (1987) (people base choices on where to live in part on legal and social environment). The federalist system allows states, in some ways, to act as "laboratories" for the development of legislation. *Arizona v. Evans*, 514 U.S. 1, 8 (1995) (citing *New State Ice*

Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)). This means that, by devising different regulatory and tax schemes, states participate in a kind of "market" in which a person can choose where he or she would prefer to locate his or her business or home. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. Econ. 416 (1956). This understanding of federalism is often called "competitive federalism," and it "put[s] the States in competition for a mobile citizenry." *Gregory*, 501 U.S. at 458. This state competition, though, *necessarily depends* on "diverting" the market—in that people must be free to choose to partake of the laws of one state over those of another.

Competitive federalism would be drastically curtailed if the decision below were to stand. States would be prevented from devising regulatory or tax schemes which might draw merchants to locate there instead of in other states. If Nevada, for example, can choose to legalize gambling, businesses such as casinos and resorts will choose to locate there instead of Utah or California. But that does not mean that Nevada's decision to allow gambling violates the Commerce Clause. *Cf. Valley Broad. Co. v. United States*, 820 F. Supp. 519, 526 (D. Nev. 1993) ("the primary federal interest relating to the social costs of gambling is limited to the protecting individual state choice on this issue").

Delaware, Montana, New Hampshire, Oregon, and Alaska have no sales tax, and as a result, people sometimes travel across state lines to buy things in those states. *See* Wyatt Buchanan, *Californians Duck Sales Tax by Shopping Across Border in Oregon*, S.F. Chron., Jan. 14, 2003, at A1, *available at* 2003 WLNR 8243261. But that does not mean that California, New York, or other states have the right to compel them to institute sales taxes so as to prevent this "diversion" of the market away from its "efficient channels." Likewise, people running corporations overwhelmingly prefer to incorporate in Delaware, to take advantage of that state's

favorable business climate and reputation for expertise in corporate law. Brett H. McDonnell, *Getting Stuck Between Bottom and Top: State Competition for Corporate Charters in the Presence of Network Effects*, 31 Hofstra L. Rev. 681, 682 (2003). The ability of businesses to choose where to incorporate has had important effects on the business community, and, as McDonnell explains, imposing a national uniform corporations law, and thus eliminating competition between the states, "would make the federal government less responsive than Delaware to changes in the business environment." *Id.* at 737. But, again, under the theory adopted by the court below, Delaware's more attractive corporate law structure would violate the Dormant Commerce Clause because it "diverts" companies into incorporating there instead of elsewhere. The decision below does serious damage to one of the primary virtues of the federalist system, which is the ability of states to compete for the approval of citizens.

Enrich, whose law review article gave birth to the "diversion" theory, contended that competitive federalism "is costly and unproductive," Enrich, *supra* at 380, because it causes states to forego tax revenues that they might have obtained if there were no such competition. No doubt this is true to a degree, but it hardly justifies imposing a monolithic tax structure on all of the states. Enrich acknowledges that his novel non-"diversion" theory of the Commerce Clause would intrude on state autonomy. *Id.* at 466. But competitive federalism, he contends, should be limited so as to allow states to "derive [more] tax revenues from major portions of the business community"—*i.e.*, to impose a monolithic tax structure on businesses throughout the country. *Id.* at 467.

There are three basic problems with this approach, however. First, the Court is bound to apply the Constitution, even where some people would prefer alternative arrangements. Competitive federalism is the law of the land, and should be applied even where courts or lawyers might prefer some other

system. *Cf. United States v. Carolene Products Co.*, 304 U.S. 144, 152 (1938). Second, competitive federalism does not harm state tax revenues, because the economy is not a zero-sum game. By encouraging investment and economic growth, tax incentives allow businesses to grow to a level that ultimately increases the tax revenue a state can exact. Third, limiting a state's autonomy so as not to exert competitive pressure on other states could threaten state autonomy in noneconomic matters as well, including morals legislation, laws regarding homosexual marriage, or other contentious matters. After all, homosexual couples might be more likely to choose to reside in—and do business in—states that allow such marriages than states that do not. Under Enrich's theory, this "tilt[s] the . . . playing field" unfairly by pressuring noncomplying states to legalize such marriages. *Cf.*, Enrich, *supra* at 467. Thus Enrich's theory "would elevate [one state's] sovereignty interests above those of [another]" by forbidding states from creating more business-friendly or socially innovative legal environments than any other state. *Franchise Tax Bd. of California v. Hyatt*, 538 U.S. 488, 498 (2003).

In short, while Enrich purports to be concerned about a "race to the bottom" among states competing for the attention of business, Enrich, *supra* at 380, his proposal actually would create a "weakest link" effect under which states would be free to raise, but not to lower taxes; to increase, but not to decrease, their regulatory burdens. A state would be forbidden to innovate to any degree which might draw businesses or citizens to that state instead of neighboring states. Adopting the Respondents' argument in this case would mean the end of the "laboratory" theory of competitive federalism.

CONCLUSION

This Court has often declared that States may "compete with other States for a share of interstate commerce," *Boston Stock Exch.*, 429 U.S. at 336-37, may "try to attract business by creating an environment conducive to economic activity," *West Lynn Creamery*, 512 U.S. at 199, n.15, and may "enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry." *Bacchus Imports*, 468 U.S. at 271. If States do have this freedom, the inevitable consequence will be a national marketplace in which states compete for the opportunity to host businesses. Such competition has long been regarded as one of the great benefits of federalism. *Gregory*, 501 U.S. at 458. The decision below—that a tax incentive program violates the Commerce Clause whenever it "diverts" a business in this way—would require uniform tax and regulatory structures in all of the States, and would do serious harm to state autonomy. The principles of federalism preclude this. The judgment of the Sixth Circuit Court of Appeals should be *reversed.*

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